

Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03

INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 SP-02

LAB-04 SIL-01 OMB-01 AGRE-00 VO-03 INSE-00 SCA-01

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INFO TREASURY WASHDC

C O N F I D E N T I A L SECTION 01 OF 02 MEXICO 14089

EO 11652:GDS

TAGS: ECON MX

SUBJECT: ECONOMIC ALERT REPORT

REF: STATE 180067, MEXICO 13393

1. SUMMARY: MEXICO'S MAIN ECONOMIC PROBLEM IS HOW TO STIMULATE ECONOMIC GROWTH WITHOUT AGGRAVATING INFLATIONARY PRESSURES. AN OPTIMISTIC FORECAST FOR THE NEXT TWELVE MONTHS IS FOR INFLATION GRADUALLY DIMINISHING TO U.S. LEVELS AND A GRADUAL INCREASE IN ECONOMIC ACTIVITY. CRITICAL FACTORS INCLUDE WAGE POLICY, PUBLIC SECTOR DEFICIT, EXTERNAL BORROWING, AND THE U.S. PROGRAM FOR UNDOCUMENTED ALIENS. PRESS STORIES OF IMMINENT SOCIAL UNREST COULD BE SELF-FULFILLING. END SUMMARY.

2. THE MAJOR ECONOMIC PROBLEM FACING THE GOM IS HOW TO STIMULATE ECONOMIC ACTIVITY WITHOUT GENERATING NEW INFLATIONARY PRESSURES. BECAUSE OF PRESUMED INCREASES IN UNEMPLOYMENT AND PRESSURES FROM BUSINESSMEN, THE GOM IS ANXIOUS TO INCREASE THE LEVEL OF ECONOMIC ACTIVITY. IT FEARS THAT DOING THIS BY INCREASING DOMESTIC AGGREGATE DEMAND WILL GENERATE ADDITIONAL INFLATIONARY PRESSURES
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THAT WOULD BE COUNTER-PRODUCTIVE. IN THIS SENSE, THE GOM IS GROING FORR A NEW DEVELOPMENT STRATEGY THAT WILL BE EXPORT-LED, BUT APPEAR TO BE A LONG WAY FROM THEIR GOAL. THEY ARE ALSO SEARCHING FOR MEANS TO STIMULATE PRIVATE INVESTMENT; THERE SEEMS TO BE SOME AWARENESS OF THE NEED TO ENCOURAGE FOREIGN INVESTMENT. THE FEAR OF LARGE-SCALE DEPORTATIONS OF UNDOCUMENTED MEXICANS FROM

THE U.S. AND/OR RESTRICTIONS ON NEW MIGRATION INCREASES
THE GOM ANXIETY ABOUT THEIR UNEMPLOYMENT PROBLEM.

3. THERE ARE SEVERAL POSSIBLE SCENARIOS FOR ECONOMIC
DEVELOPMENTS OVER THE NEXT TWELVE MONTHS.

A. THE OPTIMISTIC SCENARIO IS AS FOLLOWS. PUBLIC
SECTOR SPENDING WILL CONTINUE TO BE HELD IN CHECK. WAGE
INCREASES AS A RESULT OF COLLECTIVE CONTRACTS WILL NOT
EXCEED 15 PERCENT AND THERE WILL BE NO GENERAL WAGE INCREASE
AS IN SEPTEMBER 1976. THE RATE OF INFLATION WILL NOT
EXCEED ONE PERCENT A MONTH, AND WILL, OVER THE NEXT TWELVE
MONTHS FALL TO U.S. LEVELS. PRIVATE SECTOR CONFIDENCE WILL
STRENGTHEN AND INVESTMENT SPENDING WILL PICK UP, FINANCED
IN PART BY PRIVATE CAPITAL REFLOWS. WHILE THE CURRENT
ACCOUNT DEFICIT WILL WIDEN, IT WILL NOT EXCEED \$1.5 - \$2.0
BILLION OVER THE NEXT TWELVE MONTHS; PRIVATE SECTOR CAPITAL
INFLOWS WILL TURN POSITIVE THEREBY REDUCING THE PUBLIC
SECTOR'S EXTERNAL BORROWING REQUIREMENTS, EX-PEMEX'S GAS
PIPELINE. CLIMATIC AND POLITIC CONDITIONS WILL AID A
RECOVERY IN AGRICULTURAL OUTPUT.

B. THE PESSIMISTIC SCENARIO IS AS FOLLOWS. WITHIN
THE GOM, AND RESPONDING TO OUTSIDE PRESSURES, THE SPENDERS
WIN OUT OVER THE FISCAL CONSERVATIVES. WAGE DEMANDS GET
OUT OF HAND AND NEITHER GOM NOR LABOR LEADERS ADOPT A
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POLICY OF WORKING TO LIMIT THEM. THERE IS A GENERAL WAGE
INCREASE DEMAND TO WHICH THE GOM ACQUIESCES. THE RATE OF
INFLATION PICKS UP. THE DEMAND FOR IMPORTS SHOOTS UP. THE
PESO BEGINS TO DEPRECIATE RAPIDLY. THE FOREIGN BANKERS
GET INCREASINGLY NERVOUS. MEXICANS ONCE MORE MOVE FROM
PESOS TO DOLLARS. INDUSTRIAL ACTIVITY BEGINS TO DECLINE.
RURAL UNREST AND CLIMATIC CONDITIONS ADVERSELY AFFECT
AGRICULTURAL OUTPUT. COFFEE PRICES CONTINUE TO DECLINE.
POLITICAL FACTORS CAUSE GOM TO SLOW THE RATE OF PEMEX'S
GROWTH.

4. WE BELIEVE THE OPTIMISTIC SCENARIO WILL TURN OUT TO BE
THE MORE ACCURATE; THE PRIMARY PURPOSE OF INCLUDING THE
OTHER IS TO PINPOINT THE CRITICAL POINTS. TO SUM UP, IN
THE ECONOMIC AREA THESE ARE BUDGETARY POLICY AND WAGE
POLICY. A FAILURE TO EXERCISE RESTRAINT IN THESE AREAS
WILL BE REFLECTED IN THE RATE OF INFLATION, THE CURRENT
ACCOUNT DEFICIT, AND THE EXCHANGE RATE. DEVELOPMENTS IN
THESE THREE AREAS ARE LIKELY TO DISCOURAGE INVESTMENT AND
ADVERSELY AFFECT CAPITAL FLOWS ON WHICH THE FUTURE COURSE
OF ECONOMIC ACTIVITY DEPENDS, AT LEAST IN PART.

5. APART FROM ECONOMIC INDICATORS THERE ARE LESS TANGIBLE INDICATORS OF CRITICAL POINTS. ONE OF THESE IS THE PUBLIC PERCEPTION OF LOPEZ-PORTILLO AND THE WAY HE IS RUNNING THE GOVERNMENT. AS NOTED IN THE REFTEL THE FEAR THAT CONTINUING ECONOMIC STAGNATION COULD PRODUCE AN INCREASE IN EVENTUAL SOCIAL OR POLITICAL UNREST IS ONE FACTOR AFFECTING INVESTMENT DECISIONS. IF IT WERE TO APPEAR, AND APPEARANCES ARE VERY IMPORTANT, THAT LOPEZ PORTILLO IS NOT MASTER IN HIS OWN POLITICAL HOUSE, THIS WILL HAVE A NEGATIVE IMPACT ON INVESTMENT, SINCE IT WOULD STIMULATE THE BELIEF THAT ECHEVERRIA, FEARED AND DISLIKED BY MEXICAN

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BUSINESS IS CALLING THE SHOTS TO SOME EXTENT. HOWEVER, THE DISMISSAL OF GOMEZ VILLANUEVA BALANCING THAT OF DIAZ ORDAZ HAS ENCOURAGED MANY BUT NOT ALL OBSERVERS TO CONCLUDE THAT LOPEZ PORTILLO HAS MET A CHALLENGE AND IS EXERCISING CONTROL.

6. U.S.G. ACTIONS MAY ALSO BE CRITICAL POINTS. THE UNDOCUMENTED ALIENS PROGRAM HAS UNDOUBTEDLY CAUSED CONSIDERABLE CONCERN BECAUSE OF ITS PERCEIVED OR SUSPECTED ECONOMIC AND SOCIAL IMPACT ON MEXICO. COMING AT A TIME OF INCREASING UNEMPLOYMENT, IT COULD BE USED AS A JUSTIFICATION FOR TAKING RISKY MEASURES TO STIMULATE ECONOMIC ACTIVITY AND THEREBY INCREASE EMPLOYMENT. WE BELIEVE THAT THE U.S. UNDOCUMENTED ALIEN PROGRAM CONSTITUTES A CRITICAL POINT. IT OFFERS, ALTHOUGH IN GENERAL TERMS, SOME SPECIFIC U.S.G. POLICY ACTION IN THE ECONOMIC AREA. WHILE A VARIETY OF ECONOMIC POSSIBILITIES WERE LISTED IN PRESIDENT CARTER'S AUGUST 4 MESSAGE IN THE "COOPERATION WITH SOURCE COUNTRIES"

SECTION, THE GOM WILL BE LOOKING FOR MORE INFORMATION ON THE NATURE OF SUCH ASSISTANCE IN THE NEAR FUTURE. THEIR HOPES MAY BE PREMATURE, SINCE THE PRESIDENT'S PROGRAM IS STILL IN THE FORM OF A GENERAL PROPOSAL, WITH LEGISLATION STILL TO BE DRAFTED AND WITH CONGRESSIONAL APPROVAL OF ITS
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PROVISIONS REQUIRED. MEXICO WILL BE INCLINED TO MEASURE THE EFFECTS OF U.S. ASSISTANCE IN TERMS OF THE NUMBER OF JOBS CREATED.

7. FOREIGN PRESS STORIES SUGGESTING THE POSSIBILITY OF SOCIAL UNREST MAY BE SELF-FULFILLING IN THAT THEY COULD DEPRESS STILL FURTHER THE INTERNAL AND EXTERNAL PRIVATE INVESTMENT CLIMATE. IN THIS REGARD WE NOTE WITH SOME CONCERN THE AUGUST 8 ARTICLE IN THE WALL STREET JOURNAL AND THE ARTICLE IN THE ECONOMIST DATED AUGUST 13. BOTH HAVE AS A THEME THE POSSIBILITY OF SOCIAL UNREST IN MEXICO. WE DO NOT BELIEVE THE DANGER OF WIDESPREAD SOCIAL UNREST THAT COULD LEAD TO POLITICAL INSTABILITY IS A LIKELY PROSPECT AT THIS TIME, BUT THE POSSIBILITY DOES EXIST AND CERTAINLY FIGURES IN THE PRESIDENT'S THINKING IN RELATION TO ECONOMIC POLICY. OUR VIEW IS THAT THE SOCIAL AND POLITICAL STABILITY CAN BE BETTER ASSURED THROUGH AN EFFECTIVE STABILIZATION PROGRAM THAN THROUGH AN ATTEMPT TO REVIVE THE ECONOMY BY INCREASED PUBLIC SECTOR SPENDING THAT WOULD TEND TO LEAD TO THE SCENARIO OUTLINED IN PARAGRAPH 3B, WHICH WOULD BE LIKELY TO LEAD IN THE DIRECTION OF POLITICAL INSTABILITY.

8. WE WILL, OF COURSE, CONTINUE TO MONITOR CLOSELY BOTH ECONOMIC AND POLITICAL DEVELOPMENTS THAT COULD LEAD TO THE NEED FOR A U.S. POLICY RESPONSE.

9. MONITORING WAGE POLICY IS RELATIVELY EASY IN THAT WAGE SETTLEMENTS OFTEN BECOME PUBLICLY KNOWN. IN THIS CONNECTION, WE CAN CITE THE RECENT WAGE SETTLEMENT AT FORD. WORKERS GOT A 15 PERCENT INCREASE. ACCORDING TO A FORD OFFICIAL, LABOR LEADER FIDEL VELASQUEZ INTERVENED TO KEEP THE INCREASE AT THIS LEVEL AND AVERTED A STRIKE. THIS WOULD INDICATE THE GOVERNMENT IS KEEPING A HAND IN THIS
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AREA, THOUGH WITH LESS SUCCESS THAN EARLIER IN THE YEAR.

10. BUDGETARY DEVELOPMENTS ARE HARDER TO TRACK THOUGH A NEW PUBLICATION (SEE MEXICO 13002) MAY HELP IN THIS REGARD.

IT IS NECESSARY TO USE INDIRECT INDICATORS SUCH AS MONEY
SUPPLY AND INFLATION RATES. ANOTHER EXAMPLE IS THE CURRENCY
IN CIRCULATION OUTSIDE THE BANK OF MEXICO. THE END-MONTH
FIGURE IS AVAILABLE ON THE FIFTEENTH OF THE FOLLOWING MONTH.
AT END-JULY THIS FIGURE WAS 68.7 BILLION PESOS, 13.5 PERCENT
BELOW THE END-76 FIGURE AND MORE PERTINENTLY DUE TO SEASON-
AL FACTORS 3.9 PERCENT BELOW THE END-JANUARY FIGURE. THIS
IS DIFFICULT TO INTERPRET WITHOUT OTHER MONETARY DATA, BUT
IT WOULD INDICATE THAT THE DEFICIT IS NOT OUT OF HAND.
THOMPSON

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